BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 19199
[Redacted],	)	
	)	DECISION
Petitioners.	)	
	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditors for the Idaho State Tax Commission (Commission) dated September 28, 2005. The Notice of Deficiency Determination denied a requested refund of Idaho income tax for 2000 and asserted additional liabilities for Idaho income tax and interest in the total amounts of $9,645 and $9,920 for 2001 and 2002, respectively.

There are several issues to be addressed in this decision. They are:

1. The amount of adjustments flowing through from [Redacted], an S corporation wholly owned by the petitioners, in the amounts of $20,364 and $96,783 for 2001 and 2002, respectively.

2. Allowable depreciation was reduced by $19,796 and $120,731 for 2001 and 2002, respectively.

3. The deductions for unreimbursed expenses relating to Schedule E activities were reduced by $19,024 and $17,637 for 2001 and 2002, respectively.

4. Deductible expenses for rental property were reduced by $42,599 for 2001.

Taxpayers bear the burden of proof with regard to deductions. The U.S. Supreme Court, in addressing this issue, addressed it as follows:

> Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.
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> *　　　*　　　*

> Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440, 54 S.Ct. 788, 790 (1934).

A shareholder in a corporation is not considered to be in a trade or business and is not allowed to deduct the expenses properly deducted by the corporation. Low v. Commissioner, 154 F.2d 261 (2nd Cir. 1946). In addition, shareholders of corporations cannot attribute the business of the corporation to himself.

FLOW THROUGH FROM [Redacted]

[Redacted], the petitioners' wholly owned S corporation, was concurrently audited by the Tax Commission. A decision regarding the audit of [Redacted] is being issued concurrently with this decision. The adjustments made by the auditor to the petitioners' Idaho taxable income with regard to the audit of [Redacted] were the amounts of $20,364 and $96,783 for 2001 and 2002, respectively. The adjustments made by the Commission with regard to the audit of [Redacted] has changed these amounts to $20,364 and $96,723 for 2001 and 2002, respectively.

DEPRECIATION

The auditors disallowed depreciation with regard to the federal Schedules E filed by the petitioners in the amounts of $19,796 and $120,731 for 2001 and 2002, respectively. Of the amount of the adjustment for 2001, the Commission finds that the amount of $16,593 is allowable as pertaining to the rental of the real and personal property. The Commission finds that the remaining three items, for which depreciation is claimed, are not allowable.

For one of the items for which depreciation in the amount of $1,142 was claimed, the petitioners did not provide documentation to establish the nature of the asset or that the petitioners would be entitled to a deduction for depreciation for that item. Therefore, this adjustment is affirmed.

Other items for which the petitioners claimed depreciation included a washer and dryer and other furnishings that the petitioners contended were for the use of [Redacted]. Internal Revenue Code § 162 provides for deductions for ordinary and necessary expenses incurred in the taxpayer's trade or business. It is well established that, absent a binding obligation, a taxpayer may not deduct the expenses incurred for another taxpayer. Deputy v. DuPont, 308 U. S. 488, 493 (1940); Westerman v. Commissioner, 55 T. C. 478, 482 (1970). Therefore, corporate officers, employees, and stockholders are not generally entitled to deductions for the cost of the ordinary and necessary expenses of the corporation. Hughes v. Commissioner, T.C. Memo 1981-140; Russell v. Commissioner, T.C. Memo 1989-207; Koree v. Commissioner, 40 T.C. 961, 965-966 (1963).

In addressing a similar situation, the Tax Court stated, in part:

> Petitioners argue that in order to build up the business they chose not to extract funds from VIP and thus declined to take salary or wages. However, petitioners contend that they were, nonetheless, engaged in the trade or business of providing travel services to recreational pilots. Petitioners argue that their individual efforts on behalf of VIP were motivated by the interest in generating profits for VIP and thus for themselves. Petitioners contend that, therefore, all of the expenses which they claimed as business expenses were directly and proximately related to their VIP activities. Petitioners bear the burden of proof. Welch v. Helvering, 290 U.S. 111, 115 (1933); Rule 142(a).
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> Although the record indicates that petitioners' activities with respect to the VIP tours were devoted to furthering VIP's business, the business of VIP is not the business of its shareholders. It is well settled that a corporation and its shareholders are separate entities.

> Low v. Nunan, 154 F.2d 261 (2d Cir. 1946). Furthermore, a taxpayer may not deduct expenses which were incurred for the benefit of others. Deputy v. du Pont, 308 U.S. 488 (1940); Noland v. Commissioner, 269 F.2d 108, 109 (4th Cir. 1959), affg. a Memorandum Opinion of this Court. Because a corporation's business is distinct from that of its shareholders, officers and employees, they may not deduct expenses which promote the business of the corporation. Leamy v. Commissioner, 85 T.C. 798 (1985); Kahn v. Commissioner, 26 T.C. 273 (1956).
>
> Although the profits which result from petitioners' labors will eventually flow through to them as shareholders, the corporation remains a separate and distinct entity which cannot be disregarded. Petitioners' efforts were indisputably intended to produce profits for VIP. However, the profits petitioners will ultimately receive will be the direct result of their stock ownership rather than their efforts for VIP. Leamy v. Commissioner, *supra*; Bessenyey v. Commissioner, 45 T.C. 261 (1965), affd. 379 F. 2d 252 (2d Cir. 1967). Thus, the expenses which petitioners claimed as business deductions are properly viewed as VIP's expenses rather than petitioners' expenses.

Russell v. Commissioner, T.C. Memo 1989-207.

Clearly, the supplying of appliances and furnishings for [Redacted] would be a proper business expense for [Redacted] and not for the petitioners. Accordingly, the deduction for the depreciation of these items is denied.

For 2002, the auditors disallowed a total of $120,731 of depreciation. Of this amount, the Commission finds that $17,070 is allowable.

Of the remaining depreciation disallowed, there is a deduction claimed in the amount of $1,142 for which no documentation was provided. This portion of the adjustment is affirmed.

Two other items included in this adjustment relate to a “clean room” and to equipment which were purportedly purchased from related parties on December 31, 2002. However, it is not clear whether these assets were owned prior to the purported purchase, given that the real property at that location and some personal property was apparently leased by [Redacted] to

[Redacted] beginning in 1997. Also, the petitioners were asked for the detail of the "equipment" placed in service. No such detail was furnished. Therefore, it was not possible for the Commission to determine the nature of the "equipment" so as to be able to compute the allowable depreciation (if any) that should be allowed to the petitioners.

Included in the depreciation of the "equipment" and the "clean room," the petitioners claimed $12,000 and $45,000, respectively, as deductions pursuant to Internal Revenue Code § 179. Deductions pursuant to Internal Revenue Code § 179 are not available for depreciable property purchased from a related party. Internal Revenue Code § 179 stated, in pertinent part:

> (d) Definitions and special rules.
>
> (1) Section 179 property.
> For purposes of this section , the term "section 179 property" means any tangible property (to which section 168 applies) which is section 1245 property (as defined in section 1245(a)(3)) and which is acquired by purchase for use in the active conduct of a trade or business. Such term shall not include any property described in section 50(b) and shall not include air conditioning or heating units.
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> (2) Purchase defined.
> For purposes of paragraph (1) , the term "purchase" means any acquisition of property, but only if—
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>> (A) <u>the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267</u> or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants), (Underlining added.)

Internal Revenue Code § 267 stated, in pertinent part:

> Losses, expenses, and interest with respect to transactions between related taxpayers.

(a) In general.

(1) Deduction for losses disallowed.

No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distrbutee) in the case of a distribution in complete liquidation.

* * *

(b) Relationships. The persons referred to in subsection (a) are:

(1) Members of a family, as defined in subsection (c)(4)

* * *

(c) Constructive ownership of stock. For purposes of determining, in applying subsection (b), the ownership of stock -

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

* * *

(4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants;

Since the assets purportedly purchased on December 31, 2002, which might have qualified for treatment pursuant to Internal Revenue Code § 179, were acquired from [Redacted] parents and a corporation owned by his parents, the assets would not qualify for treatment pursuant to Internal Revenue Code § 179.

The remainder of the depreciation claimed with regard to the "equipment" and the "clean room" was also denied for lack of showing, on the part of the petitioner, the nature and business use of the assets. See Russell v. Commissioner, *supra*.

There are two other problems with the purported purchase of the assets on December 31, 2002. The first is that the real property on [Redacted] was apparently included in the purchase. It is not clear if any of the purchase price was attributed to this property. Further, there was not sufficient information in that agreement to be able to discern what [Redacted] property, or properties, were to be included in the transaction. [Redacted] family apparently owned more than one parcel on [Redacted]. It is also unclear whether the [Redacted] property or properties supposedly conveyed included depreciable assets.

Another problem with the agreement is that it does not set out the address of the purported purchaser. According to Idaho Code § 55-601, this appears to make the writing insufficient to convey title to any of the real property. It states:

> Conveyance – how made. - A conveyance of an estate in real property may be made by an instrument in writing, subscribed by the party disposing of the same, or by his agent thereunto authorized by writing. The name of the grantee and his complete mailing address must appear on such instrument.
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> Therefore the disallowance of depreciation regarding these assets is affirmed.

A [Redacted] was purchased in 2002. Depreciation based upon the full purchase price of the [Redacted] was claimed both on the return of [Redacted] and on the petitioners' return. The [Redacted] was registered to [Redacted] Therefore, in addition to other shortcomings discussed elsewhere, it appears that the petitioners were claiming depreciation on an asset that they did not own. Accordingly, this deduction is denied.

UNREIMBURSED EXPENSES

The petitioners have claimed deductions for expenses incurred with regard to [Redacted]. The auditor disallowed $19,024 and $17,637 of expenses other than depreciation for 2001 and 2002, respectively. The auditor disallowed the $19,024 and the $17,637 either due to lack of documentation or due to the expense having been claimed elsewhere on the petitioners' income tax return.

For 2001, the entire adjustment was due to the petitioners duplicating the deductions. Accordingly, the auditor's position regarding this adjustment is affirmed.

The claimed unreimbursed expenses for 2002 consist of amounts claimed for travel expenses, meals and entertainment, telephone, labor, and advertising.

The auditors' report indicates that the travel expenses and the meal and entertainment expenses were not properly documented in accordance with Internal Revenue Code § 274. In addition, the Commission suspects that many of the claimed expenses also relate to the business interest of [Redacted]. Accordingly, these adjustments are affirmed.

For the telephone and advertising adjustments, the petitioners did not provide documentation to support their position. Accordingly, these adjustments are also affirmed.

The remaining adjustment was for labor. The auditors found that the amounts deducted as labor were paid to the petitioners' children. The auditors further found that any services performed by the children were not related either to the rental of the property or to the operation of [Redacted]. Therefore, the denial of this deduction is affirmed.

For the majority of the expenses which were not adequately documented, the deficiencies in the documentation remain to this date. In addition to the rationale for the disallowance cited by the auditor, the Commission finds that the expenses here in question, if deductible at all, are the proper expenses not for the petitioners, but for [Redacted] as was discussed above. Therefore, the auditor's position with regard to these expenses is affirmed.

RENTAL EXPENSES

For 2001, the petitioners claimed $42,599.10 in deductions as rental expenses that were denied by the auditors. They were as follows:

PROPERTY A:

Car/Truck Expense	$19,007.10
Cleaning and Maintenance	1,198.00
Insurance	1,400.00
Other Interest	11.00
Repairs	1,816.00

Supplies	672.00
Utilities	1,595.00
Travel	9,951.00
Office	272.00
Contract Labor	3,212.00
Materials	2,777.00
PROPERTY B:	
Utilities	614.00
Advertising	74.00
	$ 42,599.10

The petitioners submitted documentation to substantiate some of their auto expense. However, it appeared that most of the usage of the auto or autos was for the business of [Redacted] and not for a business of the petitioners. Accordingly, most of this expense is denied. The Commission finds that $1,000 is deductible by the petitioners.

Similar problems exist with the other claimed deductions. While additional documentation has been submitted, it seldom tied to the claimed deductions. Some of the deductions were apparently duplicated, having been claimed by the petitioners both as unreimbursed expenses incurred on behalf of [Redacted] and as rental expenses. Further it appears that most or all of the deductions claimed here by the petitioners should have been paid for and claimed by [Redacted], and not by the petitioners. Therefore, the auditors' position with regard to these deductions other than the $1,000 allowed for the auto expense is affirmed.

CONTRIBUTION

A charitable contribution in the amount of $1,000 was made by [Redacted] on June 4, 2001. The auditor disallowed this deduction to [Redacted]. The contribution was not allowed in determining the amount of the deficiency for the petitioners. The Commission finds that this deduction should be allowed to the petitioners.

WHEREFORE, the Notice of Deficiency Determination dated September 28, 2005, is hereby MODIFIED, and as so modified, is APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following Idaho income tax and interest (computed to August 15, 2008):

YEAR	TAX	INTEREST	TOTAL
2001	$6,490	$2,574	$ 9,064
2002	7,287	2,422	9,709
		TOTAL DUE	$18,773

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed.

DATED this ________ day of ___________________, 2008.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ________ day of ___________________, 2008, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted] Receipt No.

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